IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

KEVIN FLUKE	:	CIVIL ACTION
	:	
v.	:	
	:	
CASHCALL, INC.	:	NO. 08-5776

MEMORANDUM

Bartle, C.J. May 21, 2009

On November 21, 2008, Kevin Fluke, a citizen of Pennsylvania, filed this putative class action lawsuit in state court against CashCall, Inc. ("CashCall"), a California corporation with its principal place of business there. Less than one month later, on December 12, 2008, CashCall removed the action to this court on the ground that the requirements of minimal diversity of citizenship and of the amount in controversy were satisfied pursuant to the Class Action Fairness Act ("CAFA") of 2005, 28 U.S.C. § 1332(d)(2) and 28 U.S.C. §§ 1441, 1446, and 1453. On March 10, 2009, we denied the motion of Fluke to remand for lack of subject matter jurisdiction to the Court of Common Pleas of Philadelphia County under 28 U.S.C. § 1447(c).[1] We have jurisdiction over this action pursuant to the CAFA.

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1. On March 10, 2009, we held that CashCall established to a legal certainty that the amount in controversy meets the "in excess of $5 million" jurisdictional threshold under CAFA and that plaintiff failed to limit the monetary claims on behalf of the class to $5 million or less.

Fluke seeks declaratory and injunctive relief compelling arbitration on a class basis and monetary relief for alleged violations of the Loan Interest and Protection Law, 41 Pa. Stat. Ann. §§ 201 and 502, and the Consumer Discount Company Act, 7 Pa. Stat. Ann. § 6203.A. He claims that CashCall preys on low income, low credit score borrowers by making loans with usurious interest rates and fees. The class of borrowers he seeks to represent are "citizens" of Pennsylvania who have been or are currently being subjected to unlawful interest rates and fees.

Now pending before the court is the motion of CashCall to stay these proceedings and compel arbitration on an individual basis.

I.

In June of 2007, Fluke, a Pennsylvania citizen, applied online for a loan with First Bank of Delaware ("FBD"), a Delaware-chartered depository institution headquartered in Wilmington, Delaware. See Jordana Gilden Decl. ¶ 8. FBD is not a party to this action. The defendant, CashCall, markets and services loans offered by federally insured banks, including FBD. It marketed and serviced the $2,600 loan issued to Fluke. Pursuant to this arrangement, FBD performed the credit scoring and underwriting of the loan, processed the loan application, and funded the approved loans, while CashCall initially marketed, advertised, and serviced the loan. See Gilden Decl. ¶ 6. The FBD Note explains this arrangement as follows:

> CashCall, Inc. has served as the marketing agent for First Bank of Delaware in this transaction; however CashCall was not responsible for and did not make any of the credit or lending decisions. All credit and lending decisions were made by First Bank of Delaware and First Bank of Delaware will originate and fund this loan.

After the loan was funded by FBD, the loan was transferred and assigned to CashCall. See Ex. B to Gilden Decl.

Before obtaining the loan, Fluke completed and electronically signed an FBD Loan Agreement, which provides for the application of Delaware law to any dispute arising from the loan. It states:

> This Note, and any claim, dispute or controversy arising from or relating to this Note, are governed by and construed in accordance with the laws of the State of Delaware (without regard to its conflicts of law rules) and applicable federal law. The legality, enforceability, and interpretation of this Agreement and the amounts contracted for, charged, and received under this Agreement will be governed by such laws. This Agreement is entered into between you and me in Delaware.

The Agreement also contains the following arbitration clause:

> ARBITRATION. PLEASE READ THIS PROVISION OF THE AGREEMENT CAREFULLY. I UNDERSTAND THAT UNLESS I EXERCISE THE RIGHT TO OPT-OUT OF ARBITRATION IN THE MANNER DESCRIBED BELOW, I AGREE THAT ANY DISPUTE WILL BE RESOLVED BY BINDING ARBITRATION. ARBITRATION REPLACES THE RIGHT TO GO TO COURT, INCLUDING THE RIGHT TO HAVE A JURY, TO ENGAGE IN DISCOVERY (EXCEPT AS MAY BE PROVIDED IN THE ARBITRATION RULES), AND TO PARTICIPATE IN A CLASS ACTION OR SIMILAR PROCEEDING. IN ARBITRATION, A DISPUTE IS RESOLVED BY AN ARBITRATOR INSTEAD OF A JUDGE OR JURY. ARBITRATION PROCEDURES

> ARE SIMPLER AND MORE LIMITED THAN COURT PROCEDURES. I ALSO AGREE ANY ARBITRATION WILL BE LIMITED TO THE DISPUTE BETWEEN MYSELF AND YOU OR THE HOLDER OF THE NOTE AND WILL NOT BE PART OF A CLASS-WIDE OR CONSOLIDATED ARBITRATION PROCEEDING.

The Agreement further provides with respect to arbitration:

> Agreement to Arbitrate. The parties agree that any Dispute, except as provided below, will be resolved by Arbitration. This agreement is governed by the Federal Arbitration Act (FAA), 9 U.S.C.S. § 1 et seq. and the substantive law of the State of Delaware (without applying its choice-of-law rules).

The Agreement gives the borrower the right to opt-out of the arbitration agreement. It states:

> Right to Opt Out. I understand that if I do not wish my account to be subject to this Arbitration Agreement, I must advise you in writing at 50 South 16th Street, Suite 2400, Philadelphia, PA 19102. I understand I must clearly print or type my name and account number and state that I reject arbitration. I understand that I must give written notice, and it is not sufficient to telephone you. I understand that you must receive my letter at the above address within sixty (60) days after the date my loan funds or my rejection of arbitration will not be effective.

Fluke did not opt out of the arbitration agreement. He proceeded to make 13 monthly payments on the loan from August of 2007 through August of 2008. Fluke Decl. Apr. 30, 2009, ¶ 4. These payments were deducted from his bank account at Commerce Bank in Pennsylvania. Id. Fluke paid CashCall $2,842.88 as repayment for the loan.

Initially, Fluke filed a claim on behalf of himself and all others similarly situated with the American Arbitration Association ("AAA") in October, 2008. In a letter to the AAA, Fluke advised that CashCall and FBD were attempting to collect an unlawful debt, that Mr. Fluke had repaid the loan plus a reasonable and lawful amount of interest, and that CashCall and FBD seek interest at the usurious and unconscionable rate of 99%. Mr. Fluke sought an accounting, a refund of the unlawfully collected interest, punitive damages, attorneys' fees, interest and costs. In his papers filed with the AAA, he maintained that the class action waiver contained in the FBD Loan Agreement is unconscionable and unenforceable and that he cannot afford to proceed individually. On November 13, 2008, Fluke filed an Amended Arbitration Claim with the AAA, which asked the arbitrator to determine that the class action waiver provision is unconscionable.

A few days later, on November 21, 2008, Fluke filed suit in the Court of Common Pleas of Philadelphia County. The complaint seeks declaratory and injunctive relief compelling arbitration on a class-action basis. According to count I of the complaint, the FBD's Loan Agreement's class-action waiver is both procedurally and substantively unconscionable under Pennsylvania law. In this complaint, Fluke seeks to represent the following class:

> All citizens of Pennsylvania who obtained an unsecured consumer term loan from CashCall for less than $25,000 where the stated APR of

> interest was greater than 6% and payments of interest were collected by CashCall within four (4) years from the filing of this action.

Counts II and III of the complaint, which are brought under the Loan Interest and Protection Law, 41 Pa. Cons. Stat. §§ 201[2] and 502[3], and the Consumer Discount Company Act, 7 P.S. § 6203.A, seek relief only in the event that Fluke's claims are decided in court, as opposed to arbitration.

II.

Both parties agree that they are required to arbitrate their dispute. As noted above, prior to filing suit, Fluke filed a claim with the American Arbitration Association. CashCall has moved under the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1-16, to stay the proceedings in this court and compel Fluke to arbitrate his individual claim only. Fluke opposes individual arbitration and argues that he is entitled to represent a class of Pennsylvania consumers who also obtained unsecured term loans from CashCall in the arbitration proceeding. Fluke asserts that the court should apply Pennsylvania law which, in his view,

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2. 41 Pa. Cons. Stat. § 201 provides: "Except as provided in Article III of this act, the maximum lawful rate of interest for the loan or use of money in an amount of fifty thousand dollars ($50,000) or less in all cases where no express contract shall have been made for a less rate shall be six per cent per annum."

3. 41 Pa. Cons. Stat. § 502 provides: "A person who has paid a rate of interest for the loan or use of money at a rate in excess of that provided for by this act or otherwise by law or has paid charges prohibited or in excess of those allowed by this act or otherwise by law may recover triple the amount of such excess interest or charges in a suit at law against the person who has collected such excess interest or charges[.]"

prohibits a class-action waiver as unconscionable and unenforceable. CashCall counters that Delaware law governs this issue and that the class-action waiver contained in the FBD Loan Agreement bars Fluke from proceeding on a class-wide basis.

The role of the court is quite narrow in deciding a matter where there is an agreement to arbitrate. Specifically, the court is limited to deciding the question of whether the parties have agreed to resolve their dispute in arbitration. Howsam v. Dean Witter Reynolds, Inc., 537 U.S. 79, 83 (2002). The Supreme Court has cautioned that these "questions of arbitrability" have a "limited scope." Id. It explained that they include "whether the parties are bound by a given arbitration clause" and "whether an arbitration clause in a concededly binding contract applies to a particular type of controversy." Id. Our Court of Appeals has similarly cautioned that the district court is limited to deciding only whether there is an agreement to arbitrate and, if so, the validity of such an agreement. Gay, 511 F.3d 369, 386 (3d Cir. 2007) (citing Great W. Mortgage Corp. v. Peacock, 110 F.3d 222, 228 (3d Cir. 1997)). If a valid agreement to arbitrate exists, the underlying dispute is left solely for disposition by the arbitrator. Id. Thus, we must first confine our review solely to the validity of the agreement to arbitrate.

Section 2 of the FAA provides that a "written provision in ... a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of

such contract or transaction ... shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. The Supreme Court has explained that this section "embodies the national policy favoring arbitration and places arbitration agreements on equal footing with all other contracts[.]" Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440, 443 (2006).

It is well settled that questions "concerning the interpretation and construction of arbitration agreements are determined by reference to federal substantive law." Gay, 511 F.3d at 388. However, the Supreme Court has held that relevant state law may be applied "if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally." Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681, 687 (1996) (citing Perry v. Thomas, 482 U.S. 483, n.9 (1987)). Thus, "generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2." Id. However, arbitration agreements may not be invalidated under state laws applicable only to arbitration provisions. Id.

In Perry, the Supreme Court explained the proper application of federal law versus state law when an agreement to arbitrate is challenged on unconscionability grounds:

> In instances such as these, the text of § 2 provides the touchstone for choosing between state-law principles and the principles of federal common law envisioned by the passage of that statute: An agreement to arbitrate

> is valid, irrevocable, and enforceable, *as a matter of federal law*, [citations omitted], "save upon such grounds as exist at law or in equity for the revocation of any contract." [citation omitted]. Thus state law, whether of legislative or judicial origin, is applicable *if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally. A state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with this requirement of § 2. [citation omitted]. A court may not, then, in assessing the rights of litigants to enforce an arbitration agreement, construe that agreement in a manner different from that in which it otherwise construes nonarbitration agreements under state law. Nor may a court rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable[.]

Id.

Our Court of Appeals recently addressed whether a class-action waiver in an agreement to arbitrate is unconscionable and unenforceable in G.R. Homa v. Am. Express Co., 558 F.3d 225 (3d Cir. 2009). In Homa, the court explained that, pursuant to § 2 of the FAA and Supreme Court precedent, federal courts must look to the relevant state law of contracts when deciding whether an arbitration agreement is unconscionable. Id. at 229. It held that the FAA does not preempt a state law defense to the enforceability of the contract's class-action waiver based on its alleged unconscionability given that such a defense is applicable to all waivers of class-wide actions and not just those that also compel arbitration. Id. It further concluded that, under the governing law of New Jersey, the class-

action waiver is unconscionable "if the claims at issue are of such a low value as effectively to preclude relief if decided individually." Id. at 233.

Thus, under § 2, we must look to the relevant state law of contracts to determine whether the class-action waiver contained in the FBD Loan Agreement's arbitration clause is unconscionable. Homa, 558 F.3d at 229. As a federal court sitting in diversity in Pennsylvania, we must apply the choice-of-law rules of Pennsylvania in deciding whether the contractual designation of Delaware law is enforceable. Klaxon Co. v. Stentor Elec. Mfg. Co., Inc., 313 U.S. 487 (1941).

Pennsylvania courts generally will apply the choice of law agreed to by the contracting parties. Miller v. Allstate Ins. Co., 763 A.2d 401, 403 (Pa. Super. 2000). However, the Pennsylvania Supreme Court "has recognized that choice-of-law agreements can be avoided when the terms offend Commonwealth public policy even in disputes between contracting parties." Pennsylvania Dep't of Banking v. NAS of Delaware, LLC, 948 A.2d 752, n.9 (Pa. 2008). This principle is embodied in § 187 of the Restatement (Second) of Conflict of Laws, which has been adopted by Pennsylvania courts. Schifano v. Schifano, 471 A.2d 839, 843 (Pa. Super. 1984); Kruzits v. Okuma Mach. Tool, Inc., 40 F.3d 52, 55 (3d Cir. 1994). Section 187 provides:

> The law of the state chosen by the parties to govern their contractual rights and duties will be applied, even if the particular issue is one which the parties could not have

> resolved by an explicit provision in their agreement directed to that issue, unless
>
> (a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or
>
> (b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of § 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.

Restatement (Second) Conflict of Laws § 187.

Here, the choice-of-law provision in the contract between FBD and Fluke designates Delaware law as controlling the parties' dispute under the Note. FBD is incorporated in Delaware and has its principal place of business there. Thus, it cannot be said that Delaware has no substantial relationship to the parties or the transaction pursuant to subsection (a) of § 187.

We must determine, then, whether application of Delaware law would be contrary to a fundamental policy of a state which has a materially greater interest in the determination of the particular issue and which would be the state of the applicable law in the absence of the Loan Agreement's choice of law provision. Pennsylvania has a materially greater interest than Delaware in the resolution of this dispute. Fluke is a citizen of Pennsylvania and he applied for and obtained the loan from FBD in Pennsylvania. He seeks to represent other Pennsylvania citizens that also obtained unsecured consumer loans

from FBD. The FBD Loan Agreement directs that any consumer complaints be directed to FBD in Philadelphia, Pennsylvania. Borrowers are also directed to write to FBD at its offices in Philadelphia, Pennsylvania in the event they wish to opt-out of the arbitration agreement. CashCall deducted Fluke's monthly payments from his bank account in Pennsylvania. In contrast, the only contact that Delaware has with this transaction is that FBD is a citizen of that state. However, as noted earlier, FBD, which assigned the note and loan to CashCall, is no longer a party to this transaction or dispute.

Under Delaware law, a class-action waiver provision in an arbitration agreement is enforceable. Pick v. Discover Fin. Servs., Inc., No. 00-935, 2001 WL 1180278 *5 (D. Del. Sept. 28, 2001). In contrast, the Pennsylvania Superior Court has held that an agreement to arbitrate in a contract of adhesion that waives the right to class-action relief is unconscionable and unenforceable. Thibodeau v. Comcast Corp., 912 A.2d 874, 886 (Pa. Super. 2006). A contract of adhesion is a "standardized form contract presented to consumers without negotiation or any option for modification." Id. at 882. In reaching this holding, the Pennsylvania Superior Court stressed that "Pennsylvania law, like the FAA, favors arbitration." Id. at 880. Nonetheless, "where the arbitration clause is contained in an adhesion contract and unfairly favors the drafting party, such clauses are unconscionable and must be deemed unenforceable." Id. The Comcast Customer Agreement in Thibodeau, which contained an

agreement to arbitrate with a class action waiver, was unenforceable, according to the court, because it was a "contract of adhesion unilaterally imposed on all consumers." Id. at 885. The court reasoned that consumers are "subject to every term without choice[.]" Id. It explained that "Mr. Thibodeau was forced to accept every word of all 10 pages of the mass-delivered Comcast Customer Agreement or have no cable television service whatsoever, since Comcast holds a government-authorized geographic monopoly." Id. Furthermore, the class action waiver effectively precluded customers from bring suit against Comcast over disputes involving small amounts of money because of the unlikelihood of an individual expending the time and money to litigate such a small claim. Id. Thus, the clause precluding class actions was unconscionable. Id.; see also Lytle v. CitiFinancial Servs., 810 A.2d 643 (Pa. Super. 2002).

We predict that the Pennsylvania Supreme Court, in accordance with Thibodeau, would hold that Pennsylvania public policy prohibits as unconscionable absolute class action waivers in a contract of adhesion. See Franklin Prescriptions, Inc. v. New York Times Co., 424 F.3d 336, 341 (3d Cir. 2005). However, the Pennsylvania courts have not yet addressed whether a class action waiver that contains an opt-out clause, such as the one at issue here, is unconscionable and unenforceable. Fluke's loan agreement contained a provision giving him the right to opt-out of the arbitration agreement. To do so, Fluke was required to

give written notice within 60 days after the date that his loan was funded.

Although Pennsylvania courts have not yet addressed this issue, other courts have found that an agreement to arbitrate that contains an opt-out provision is not unconscionable because such agreements are not unilaterally imposed but instead give the consumer a meaningful choice as to the contract's terms. For instance, in Guadagno v. E*Trade Bank, 592 F. Supp. 2d 1263 (C.D. Cal. 2008), the plaintiff filed a putative class-action lawsuit against E*Trade, the bank at which she held an interest-earning account, in connection with its practice of holding money withdrawn from her account for 3 days prior to sending it to the creditor she wished to pay. E*Trade moved to compel arbitration pursuant to the account agreement's arbitration clause.

When applying for the account, the plaintiff filled out an online application, which contained an arbitration agreement with a class-action waiver provision. Like Fluke, the plaintiff was permitted to opt-out of the arbitration agreement and class-action waiver provided she give notice within 60 days of signing the agreement. Id. at 1268.

The plaintiff argued, among other things, that the agreement to arbitrate was unconscionable and unenforceable because it contained a class-action waiver provision. In determining whether to enforce the agreement's choice of law provision, the court analyzed whether the application of Virginia

law would contradict a fundamental public policy of California. Id. at 1269. The court noted California's public policy against exculpatory class-action waivers in contracts of adhesion but highlighted that a contract is not an adhesive one if the consumer has a meaningful opportunity to opt out of a term after entering the contract. The plaintiff was given that right but did not exercise it. The court concluded that "the Arbitration clause containing the waiver was not presented on a take-it-or-leave-it basis, but gave Guadagno sixty days to opt out" and, for this reason, it was not unconscionable. Id. at 1270. Thus, California public policy would not be offended by the application of Virginia law.

The court further held that the class-action waiver provision was not unconscionable under Virginia law given that the agreement required E*Trade to pay half of the arbitration fees and also gave the plaintiff the opportunity to ask E*Trade to pay a higher share of the fee. Furthermore, the plaintiff provided no proof that the costs of arbitration were prohibitively expensive to her. Id. at 1272.

A similar result was reached in Honig v. Comcast of Georgia I, LLC, 537 F. Supp. 2d 1277 (N.D. Ga. 2008), which involved a claim by a Comcast customer that she was improperly charged $16.40 without her authorization. The Comcast subscriber agreement contained a binding arbitration provision with a class-action waiver. However, the agreement also contained an opt-out provision giving the customer the right to opt out of the

agreement to arbitrate by notifying Comcast in writing within 30 days of receiving the agreement. Id. at 1281.

Comcast moved to compel arbitration of the dispute. As in Guadagno, the plaintiff argued the arbitration provision was unenforceable because it contained an unconscionable class-action waiver. According to the plaintiff, she and members of the proposed class would be precluded from meaningful relief if the court were to enforce the class-action waiver in light of the small amount in dispute and the difficulty of obtaining counsel to handle the claim. Id. at 1286.

The court reasoned that the plaintiff's "ability to recover attorney's fees on most her claims if she prevails provides an attorney ample incentive to represent her and pursue all of her claims in arbitration." Id. at 1288. Furthermore, the arbitration provision provided for Comcast to advance the filing fee and costs of arbitration. However, the most important factor in the analysis, according to the court, was the fact that the customer was "free to reject the terms of the arbitration provision without a single adverse consequence." Id. at 1289. It concluded that her "ability to opt out of the arbitration provision dilutes her unconscionabilty argument because the provision was not offered on a take-it-or-leave-it basis." Id. It noted that "Courts have stressed the importance of such opt-out provisions in enforcing class action waivers in arbitration agreements." Id.

We predict that the Pennsylvania Supreme Court would agree with the reasoning of the district courts in Guadagno and Honig. An opt-out provision, like the one in Fluke's agreement with FBD, seriously undermines a consumer's contention that the arbitration agreement is unconscionable. Fluke was given the option to say "no" to the arbitration provision and he was given a full 60 days to do so. In that way, he had complete control over the terms of the agreement and it cannot be said that the arbitration agreement was presented to him on a take-it-or-leave-it basis. Furthermore, like the agreements in Guadagno and Honig, the FBD loan agreement requires that FBD pay the filing fee and any costs and fees charged by the arbitrator regardless of which party initiates the arbitration. Moreover, under § 503 of the Loan Interest and Protection Law, a borrower or debtor who prevails in an action "shall" recover a reasonable attorneys' fee. 41 Pa. Cons. Stat. § 503. This should alleviate any concern regarding the availability and willingness of counsel to represent him. Accordingly, this case differs materially from Thibodeau and is more analogous to Guadagno and Honig. We predict that the Pennsylvania Supreme Court would hold that the arbitration provision in the loan agreement in issue is not unconscionable and is enforceable.

In summary, under either Pennsylvania or Delaware law, we hold that the class action waiver with its 60 day opt-out clause, is not unconscionable under the circumstances presented

here. Accordingly, we will enter an Order compelling arbitration of this matter on an individual basis only.